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769-535—65

In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 886

THE BOEING COMPANY, A DELAWARE CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims (Pet. 11–36) is reported at 338 F. 2d 342.

JURISDICTION

The judgment of the Court of Claims was entered on November 13, 1964. The jurisdiction of this Court has been invoked under 28 U.S.C., Section 1255(1).

QUESTION PRESENTED

Taxpayer entered into fixed-price contracts with the government for the production of aircraft. Pursuant to those contracts, taxpayer received partial pay-

ments from the government on work-in-process in amounts which could not exceed 90% of the cost to taxpayer of the property on which the payments were made. The contracts expressly provided that, upon the making of any partial payment, title to all work-in-process would immediately vest in the government. The question presented is whether the Court of Claims erred in holding that taxpayer, in computing its total assets for excess profits credit purposes under Section 442(f) of the Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137, was not entitled to include both the entire cost of work-in-process and the cash received from the government as partial payment.

STATUTES INVOLVED

Sections 442(f), 446(a) and 446(b) of the Internal Revenue Code of 1939, as amended, are set out in the Appendix, *infra*.

STATEMENT

During the years 1946 through 1949, taxpayer had fixed-price government contracts for the production of aircraft. In the performance of these contracts, taxpayer made expenditures for materials and labor which resulted in items of value in the nature of work-in-process inventory. During the course of taxpayer's performance of the contracts, it received partial payments from the government. Under the terms of the contracts, partial payments were defined as "payments prior to delivery, on work in progress for the Government under this contract." Payments were permitted to be made upon property acquired or produced for the contract in an amount which

"shall not exceed 90 percent of the cost to the Contractor of the property upon which payment is made." The article specifically provided that, upon the making of any such partial payment, "title to all parts, materials, inventories, work in process and non-durable tools theretofore acquired or produced by the Contractor for the performance of this contract, and properly chargeable thereto * * * shall forthwith vest in the Government." It was also provided that, in making final payments for the aircraft, "there shall be deducted from the contract price therefor a proportionate amount of the partial payments theretofore made." (Pet. 12–13.)

Prior to the enactment of the Excess Profits Tax Act of 1950, taxpayer, in the calculation of its assets on the balance sheets which it submitted with its federal tax returns and also published to its stockholders, regarded partial payments as effecting a transaction in the nature of a sale to the Government, accompanied by a passage of title, of an equivalent amount of work-in-process inventory. Accordingly, the inventory asset item was reduced by the amount of the partial payment, while the "cash" asset item was correspondingly increased. Thus, the total amount of taxpayer's assets was not affected by the payment, there being simply an exchange of cash for work-in-process inventory. (Pet. 13–14.)

After the enactment of the Excess Profits Tax Act of 1950, however, taxpayer adopted a different method. Its excess profits tax under the 1950 Act was based on its average net income during a pre-1950 base period. By Section 446 of the 1939 Code,

taxpayer, as a member of a "depressed industry subgroup," was permitted to compute its average base period net income by a formula which was based upon the average of the amounts of its "total assets" computed as of certain base period dates (December 31 for the years 1946–1949). An increase in the "total assets" figure had the effect of increasing taxpayer's excess profits credit and reducing its excess profits tax. This was accomplished by including in the "total assets" computation not only the full amount of work-in-process, but also the cash received from the government as "partial payments." (Pet. 12, 14.)

In defense of this method, taxpayer contended, in substance, that since it continued to bear the risk of loss or damage to the property, the interest which vested in the government upon partial payment was not full ownership, but only a kind of security title, and that the payments themselves amounted to nothing more than cash borrowed from the government. This contention was rejected first by the Commissioner of Internal Revenue, and, ultimately, by the Court of Claims. (Pet. 14–15.)

Although the Court of Claims regarded the contract provisions as shifting ownership of work-in-process to the government upon the making of partial payments, it conceded that such payments performed the same general function as loans, and, for some purposes, might be considered as such. (Pet. 29–30.) The Court of Claims agreed, however, with the Fifth Circuit (*Anderson Brothers Corp.* v. *Commissioner,* 296 F. 2d 627) that it would be contrary to legislative intent to include in "total assets" both

the full cost of work-in-process and the cash received from the government as partial payments, since the latter was merely a substitute for the former.

ARGUMENT

The decision below is correct, and there is no conflict or any other reason for further review.

1. If the taxpayer had not received any partial payments from the government, its excess profits tax credit under Section 442(f) of the 1939 Code, Appendix, *infra*, p. 9, would have included the cost of its work-in-process inventory. The question here is whether the taxpayer, having received partial payments covering up to 90% of these costs, could include in its "total assets" not only the full cost of its work-in-process inventory but also the full amount of cash paid over by the government. Plainly, this would have resulted in a duplication of items and a consequent exaggeration of taxpayer's investment for excess profits tax credit purposes, and the Court of Claims properly disallowed it. The issue here was closely related to the excess profits tax credit issue in *Anderson Brothers Corp.* v. *Commissioner*, 34 T.C. 199, affirmed, 296 F. 2d 627 (C.A. 5th), and the court below adhered to the reasoning of both the Tax Court and the Fifth Circuit in that litigation. (Pet. 26–27, 31–34.) The crux of the matter to all three courts was that the term "total assets", if it is to serve any intelligible legislative purpose, must be construed to bar recognition as assets of items which tend to be mere duplications of other assets. As the Fifth Circuit observed (296 F. 2d 627, 630), "It would seem

that even to pose the proposition that the expenditure item continues to be property even after cash has been received in full payment of the amount of the expenditures is to answer it."

2. There is no conflict. Neither of the cases relied upon by petitioner (*American Motors Corp.* v. *Kenosha,* 356 U.S. 21, rehearing denied, 357 U.S. 912, and *Consolidated-Hammer Dry Plate & Film Co.* v. *Commissioner,* 317 F. 2d 829 (C.A. 7)) involves the interpretation of the excess profits tax provision at issue here. The question in *American Motors* was whether, despite the partial payment and title-passing provisions of the procurement contract, certain aircraft engine inventory remained the property of the contractor under local law and was thus subject to a city personal property tax. In *Consolidated-Hammer,* the question was whether the partial payments received by the contractor were taxable for federal income tax purposes at the time of receipt or only upon delivery of the completed airplane. To be sure, the premise of both decisions was that the partial payment provision did not operate to transfer title to the government for the particular purpose relevant to the case. But we do not believe this provision need be construed in the same way for all purposes. The cases cited by the petitioner, as well as the many other decisions cited by the Court of Claims, are at most instructive analogies. And, as is evident from the extensive survey of decisions made by the court below, the weight of authority is to the effect that the partial payment provision does operate to transfer legal title to the government.

3. The actual holding of the court below, as distinguished from its characterization of the title-passing provision, has no importance to the administration of the internal revenue laws. The case involves the construction of a long-expired excess profits tax provision, and a survey conducted by the Internal Revenue Service has unearthed only three other claims involving the same issue. Of these three claims, two (presented by this same taxpayer) are pending before the Internal Revenue Service, while a third is in litigation (*Douglas Aircraft Co.* v. *United States,* Civil No. 1610–61–CC (S.D. Calif.)).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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APRIL 1965.

APPENDIX

Internal Revenue Code of 1939:

SEC. 442 [as added by Sec. 101 of the Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137, and as amended by Sec. 510 of the Revenue Act of 1951, c. 521, 65 Stat. 452]. AVERAGE BASE PERIOD NET INCOME—ABNORMALITIES DURING BASE PERIOD.

* * * * *

(f) TOTAL ASSETS.—For the purposes of this section, the taxpayer's total assets for any day shall be determined as of the end of such day and shall be an amount equal to the excess of—

(1) the sum of the cash and the property other than cash, inadmissible assets, and loans to members of a controlled group as defined in section 235(f)(4)) held by the taxpayer in good faith for the purposes of the business, over

(2) the amount of any indebtedness (other than borrowed capital as defined in section 439 (b)(1)) to a member of a controlled group (as defined in section 435(g)(6)) which includes the taxpayer.

Such property shall be included in an amount equal to its adjusted basis for determining gain upon sale or exchange, determined under the rules provided in section 441.

* * * * *

(26 U.S.C. (1952 ed.) 442.)

SEC. 446 [as added by Sec. 101 of the Excess Profits Tax Act of 1950, *supra*]. AVERAGE BASE PERIOD NET INCOME—DEPRESSED INDUSTRY SUBGROUPS.

(a) IN GENERAL.—If a taxpayer which commenced business on or before the first day of its base period is a member of a depressed industry subgroup, as defined in subsection (c), its average base period net income determined under this section shall be the amount computed under subsection (b).

(b) AVERAGE BASE PERIOD NET INCOME.—The average base period net income determined under this section shall be computed as follows:

(1) By determining the amount of the taxpayer's total assets for the last day of each of its taxable years ending after the first day of its base period and prior to the first day of its first taxable year under this subchapter.

(2) By computing the average of the amounts ascertained under paragraph (1).

(3) By multiplying the amount ascertained under paragraph (2) by the adjusted rate of return, proclaimed by the Secretary under subsection (e), for the taxpayers' industry subgroup.

(4) By determining the aggregate amount of interest paid or incurred by the taxpayer for all taxable years ending after the first day of its base period and prior to the first day of its first taxable year under this subchapter, dividing such aggregate by the total number of months in such years and multiplying the quotient by 12.

(5) By subtracting the amount ascertained under paragraph (4) from the amount ascertained under paragraph (3).

* * * * *

(26 U.S.C. (1952 ed.) 446.)

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